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CHARLES ELMORE C

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931

No. 672

PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOE A. WORSHAM,
J. M. BURFORD,
J. L. GAMMON,
Counsel for Petitioners.

WORSHAM, ROLLINS, BURFORD,
RYBURN & HINCKS,
Dallas, Texas,
Of Counsel.

(36,486)

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PLANTERS COTTON OIL COMPANY, INC., OF WAXAHACHIE, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF TEXAS.

PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THE COURT:

Summary Statement of the Matters Involved.

A.

The petition of Planters Cotton Oil Company, Inc., Waxahachie, Planters Cotton Oil Company, Inc., Ennis, Planters Cotton Oil Company, of Waxahachie, Planters Cotton Oil Company, of Ennis, and Farmers Gins, Inc., shows to this Honorable Court:

This case was tried in the District Court, Northern District of Texas, upon stipulated facts. Although the stipulation provided that either party could introduce other evidence, not in conflict with the stipulation, no other evidence was introduced (Record pp. 12 *et seq*). The facts are therefore not in dispute. It is admitted and agreed that the Planters Cotton Oil Company, Waxahachie, Texas, and Planters Cotton Oil Company, Ennis, Texas, joint stock associations, were, during the fiscal year ending June 30, 1924, affiliated associations taxable as corporations within the meaning of the Internal Revenue Act of the United States, and that for said year they actually filed a consolidated corporation tax return with the Collector of Internal Revenue, Second District of Texas; that of the 1,500 outstanding shares of the Waxahachie Company, H. N. Chapman owned 1,457, and of the 2,500 outstanding shares in the Ennis Company, H. N. Chapman owned 2,457. It was further agreed that for the fiscal year ending June 30, 1924, the Waxahachie Company sustained a net loss of $182,284.86 and the Ennis Company sustained a net loss of $23,746.17, making a total of $206,031.03, as was shown in said return (Sec. 3 of the Stipulation, R. pp. 14-15).

It was further agreed that on August 18, 1924, the petitioners, Planters Cotton Oil Company, *Inc.*, of Waxahachie, and the Planters Cotton Oil Company, *Inc.*, of Ennis, were each incorporated, the Waxahachie Company having a capital stock of $200,000.00 and the Ennis Company having a capital stock of $300,000.00, each of which was divided into shares of

the par or face value of $100.00, and of which H. N. Chapman owned 1,940 out of 2,000 shares in the Waxahachie Company, Inc., and 2,940 out of 3,000 shares in the Ennis Company, *Inc.* That on the 6th day of September, 1924, the Farmers Gins, Inc., was duly incorporated with a capital stock of $125,000.00, divided into 1,250 shares of the par value of $100.00 each, and that of said shares H. N. Chapman owned 1,204; that each of the three corporations was incorporated under the laws of the State of Texas; that their capital stock was fully paid up and the stock therein issued in consideration of the transfer of certain assets to them, respectively, by the Planters Cotton Oil Company, of Waxahachie, and the Planters Cotton Oil Company, of Ennis, the above mentioned joint stock associations, which transferred assets constituted the entire assets of said new corporations (Secs. 3, 4, 5 and 6, pp. 14-16 of the Record).

After the incorporation of Planters Cotton Oil Company, *Inc.*, of Waxahachie, the Planters Cotton Oil Company, *Inc.*, of Ennis, and the Farmers Gins, Inc., there were then five affiliated corporations, as follows: Planters Cotton Oil Company, Waxahachie, Planters Cotton Oil Company, Ennis, Planters Cotton Oil Company, *Inc.*, Waxahachie, Planters Cotton Oil Company, *Inc.*, Ennis, and Farmers Gins, Inc., and the aforesaid two joint stock associations and three corporations were affiliated corporations within the meaning of the Internal Revenue Act of the United States (Sec. 7 of the Stipulation, p. 16 of the Record), in that H. N. Chapman owned more than 95 per cent of all of the

stock in each of said joint stock associations and said corporations (pp. 14 and 16 of the Record).

It was further agreed that for the fiscal year ending June 30, 1925, said affiliated group, consisting of the five companies aforesaid, were entitled to, and did, file a consolidated income tax return for said period, and that, as disclosed by said return, they sustained a net income for the fiscal year ending June 30, 1925, of $69,237.00. That the following members of said affiliated group realized a net income as follows:

Planters Cotton Oil Company, Inc., Waxahachie	$52,981.25
Planters Cotton Oil Company, Inc., Ennis	79,476.21
Farmers Gins, Inc.	15,178.79
Total	$147,636.25

That the following members of said affiliated group realized a net loss as follows:

Planters Cotton Oil Company, Waxahachie	$72,699.65
Planters Cotton Oil Company, Ennis	5,699.60
Total	$78,399.25

That an income tax was assessed upon said net income of the group in the sum of $8,827.72, and the same was paid to the defendant by the Planters Cotton Oil Company, Inc., for and upon behalf of itself and the other petitioners herein, together with the additional amount of $54.80 interest (Record, p. 17). It was further stipulated that no part of said amount had been refunded.

Petitioners asserted in the courts below that the losses sustained by the two associations for the fiscal taxable year ending June 30, 1924, as above set out, should be allowed as deductions in computing their respective net incomes for the fiscal taxable year ending June 30, 1925, and that such net income when so computed should be reflected in the aggregate of the group. It is admitted that the losses of the two associations for 1924 were in excess of the net income of the group for 1925, when computed without taking the 1924 loss into consideration. The Commissioner refused to allow such claimed deductions on the ground that the companies that sustained the losses in 1924 also sustained losses in 1925.

Judgment was rendered against Petitioners in the trial court, 47 Federal (2) 659. Its judgment was affirmed by the Circuit Court of Appeals, Fifth Circuit. In its opinion, the Circuit Court of Appeals decided two questions of law adverse to the contention of Petitioners; the first of which was decided by it in the case of *Woolford Realty Co., Inc.*, v. *Rose, Collector*, and, in the instant case, its ruling on that question in the Woolford case is merely referred to. It becomes necessary, therefore, to refer to that decision as it was applied in this case.

First Issue.

In the *Woolford case*, the Court itself states the issue to be:

> "* * * Whether the words 'net income' used in Section 206-*b* may mean 'minus net in-

come', or loss, so as to permit a statutory net loss to be availed of by the affiliated group, not merely to the extent of reducing the amount of the corporation entitled to it on which the affiliated group must pay taxes, but of producing a loss or a minus quantity which the affiliated group may use as a deduction from the net income of the member."

Determining the issue, the Court says:

"That the statutory net loss deduction was personal to the tax payer sustaining it and could be availed of in the following year by that tax payer alone and by him only to the extent that he had net income in that year."

Second Issue.

It was the contention of Petitioners that even if the Court's determination of the First Issue was correct as applied to the facts in the *Woolford case,* it was inapplicable to the facts in the instant case, in that one person, H. N. Chapman, at all times owned substantially all the stock in the five companies; that there was not, in 1925, corporate affiliation of interest distinct in 1924, as there was in the *Woolford case,* and that the entire tax ultimately fell on H. N. Chapman.

The Court, in recognizing this distinction, says:

"In *Woolford Realty Company* v. *Rose,* decided November 13th, this Court had occasion to consider generally the question herein involved. There after full consideration we decided that the statutory net loss deduction was personal to the tax payer sustaining it, could be availed of in the following year by that tax payer alone, and by him only to the extent that he had net income in that year. That it could not be availed

of to create a minus net income or loss which might be used by a member of the group which did have net income as a positive deduction against that income.

"Were this a case as that one was, of corporate affiliation of interests theretofore distinct, brought about after the net losses had been sustained, we should dispose of this case by a mere reference to that opinion. Since, however, the differentiating facts appear here as they did in the case of *National Slag Co.* v. *Com'r,* 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case* two companies so owned having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do."

As is apparent from the above quotation, the Court of Circuit Appeals recognized that this case did not present one of "corporate affiliation of interest theretofore distinct, brought about after the net losses had been sustained," but that "differentiating facts appear here as they did in the case of *National Slag Co.* v. *Commissioner,* 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies". But whether or not "these dif-

ferences of fact require a different legal conclusion" to that reached in the *Woolford case*, the Court says:

"We do not think they do."

B.

Reasons Relied on for the Allowance of the Writ.

The Circuit Court of Appeals held:

First.

(*a*) That the statutory "net loss" incurred by a corporation one year was personal to the tax payer and may be used as a deduction in computing its net income for the second year, under Section 206-*b*, by that tax payer alone, and by him only to the extent that he has a net income for the second year.

(*b*) That a statutory net loss accruing to a corporation when unaffiliated with any other corporation may not be used by it in a subsequent year when affiliated with another, in computing, not simply its own income, but the income of the other members of the group, and the fact that a single individual may at all times own over 95 per cent of each corporation of the affiliated group, and that the tax will ultimately fall on him; and that the creation of the new corporations constituted a mere paper change did not alter the rule.

These conclusions decide most important legal questions—questions that have not been decided and settled by this Honorable Court. That the questions herein presented are of importance not only to Petitioners but to a large number of tax payers throughout the country cannot be doubted. Not only have numerous decisions been handed down, many in conflict with the holding of the Circuit Court of Appeals in

the instant case (as will hereinafter appear), but doubtless many cases involving the same questions are now pending in the Courts as well as before the Board of Tax Appeals. The questions determined by the Circuit Court of Appeals and here presented have frequently arisen in the past, and the making of income tax returns in the future, in similar cases, will and must be determined by the final holding in this case.

We submit, therefore, that it is most important, not only that the conflicts in judicial construction be reconciled, but that the uncertainty that exists, and the importance generally, in regard to this question be definitely and finally determined by this Court.

Second.

The decision in this case, in so far as it construes the language used in Section 206-*b*, reading as follows:

> "Shall be allowed as a deduction in computing the net income of the tax payer for the succeeding taxable year (hereinafter in this section called 'second year'),"

is in direct conflict with the following Circuit Court decisions:

National Slag Co. v. *Commissioner,* 47 Federal (2) 846, Court of Appeals, Third Circuit;

Burnett, Commissioner, v. *Moore Cotton Mills,* 49 Federal (2) 59, Court of Appeals, Fourth Circuit.

It is also in conflict with the following decisions of the Board of Tax Appeals:

Alabama By-Products Corporation, 18 B. T. A. 919.

Ginsburg Company, 19 B. T. A. 81.

Buckie Printers Ink Co., 19 B. T. A. 943.
Pittsburg Gasoline Co., 21 B. T. A. 297.
General Box Corporation, 22 B. T. A. 725.
Arrow Coal & Ice Co., 22 B. T. A. 1341.
Tollerton & Warfield Company, 23 B. T. A. 892.
Hawley Investment Company, 23 B. T. A. 953.
Small's Inc., 24 B. T. A. 686.
Abelson Realty Company, Inc., 24 B. T. A. 686.
Summerfield Company, 24 B. T. A. 829.

Third.

The holding in this case as follows:

> "Since, however, the differentiating facts appear here as they did in the case of *National Slag Co.* v. *Commissioner*, 47 Federal (2) 846, that one person has at all times been substantially the owner of all of the stock in all of the companies involved, and that the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case*, two companies so owned having been consolidated, in this case five companies so owned having been created out of the two which had sustained the net loss, it becomes necessary for us now to determine whether these differences of fact require a different legal conclusion. We do not think they do;"

is in direct conflict with the decisions of the United States Circuit Court of Appeals in the case therein referred to, *National Slag Company* v. *Commisisoner*, 47 Federal (2) 846 (Third Circuit); *Western Maryland Railroad* v. *Commissioner*, 33 Federal (2) 695 (Fourth Circuit); *Jackson* v. *M. H. Thomas Inv. Co.*,

46 Federal (2) 252, by the Fifth Circuit; and of the decisions of the Honorable Court in *Chicago, Milwaukee & St. Paul Ry. Co.* v. *Minneapolis Civic Association,* 247 U. S. 490, 38 Sup. Ct. Rep. 553, 557; 62 Law Ed. 1229; *Southern Pacific Company* v. *Lowe,* 247 U. S. 330; 38 Sup. Ct. Rep. 540; 62 Law Ed. 1142; *Gulf Oil Corporation* v. *Lewellyn,* 248 U. S. 71, 39 Sup. Ct. Rep. 35; 63 Law Ed. 133.

Fourth.

The Circuit Court of Appeals disregarded the rule of construction of tax statutes, announced by this Court, as follows:

(*a*) That such statutes are strictly construed against the taxing power;

(*b*) That such statutes cannot be extended by implication;

(*c*) Ambiguity in a tax statute should be resolved in favor of the taxpayer.*

WHEREFORE your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, for the Fifth Circuit, commanding that court to certify and send to this Court,

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* *Burnett* v. *Moore Cotton Mills* (C. C. A., 4th Cir.), 49 Fed. (2) 59, 61, and U. S. Supreme Court cases there cited, as follows:

Gould v. *Gould,* 245 U. S. 151, 62 L. Ed. 211.
U. S. v. *Merriam,* 263 U. S. 179, 68 L. Ed. 240.
Reinecke v. *Trust Co.,* 278 U. S. 339, 73 L. Ed. 410.

on a day certain to be therein designated, a full and complete transcript of the record and of all proceedings in the said Circuit Court of Appeals, in the case entitled: Planters Cotton Oil Company, Inc., Waxahachie, Texas, et al., Appellants, *vs.* George C. Hopkins, Collector of Internal Revenue, Appellee, No. 6243, and that the said decree of the United States Circuit Court of Apepals, for the Fifth Circuit, may be reversed by this Honorable Court, and that your Petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your Petitioners will ever pray.

PLANTERS COTTON OIL COMPANY, INC., WAXAHACHIE,
PLANTERS COTTON OIL COMPANY, INC., ENNIS,
PLANTERS COTTON OIL COMPANY, WAXAHACHIE,
PLANTERS COTTON OIL COMPANY, ENNIS,
FARMERS' GINS, INC.,
By JOE A. WORSHAM,
Dallas, Texas,
J. M. BURFORD,
Dallas, Texas,
J. L. GAMMON,
Waxahachie, Texas,
Attorneys for Petitioners.

WORSHAM, ROLLINS, BURFORD, RYBURN & HINCKS,
Dallas, Texas,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

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No. 672

PLANTERS COTTON OIL COMPANY, INC., WAXAHACHIE, TEXAS, ET AL., PETITIONERS,

vs.

GEORGE C. HOPKINS, COLLECTOR OF INTERNAL REVENUE, RESPONDENT.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The opinion of the District Court is reported in the 47 Federal (2) 659. The opinion of the Circuit Court of Appeals rendered on the 20th day of November, 1931, has not yet been printed in the Federal Reporter, but appears in the Record at pages 47 to 51, inclusive.

The decision of the Circuit Court of Appeals in the instant case, in so far as the construction of the ap-

plicable statutes is concerned (particularly Sec. 206 (*b*) of the Internal Revenue Act of Congress, 1926), is based by mere reference upon its decision in the case of *Woolford Realty Company* v. *Rose, Commissioner*, in which case application for writ of certiorari has been made to this Court, Cause No. 582.* The decision in the *Woolford case* has not been officially reported, but it is found in the record in said Cause No. 582, pages 17 to 24, inclusive.

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended, United States Code, Title 28, Sec. 347.

2. The date of the judgment to be reviewed is November 20, 1931 (Record 52).

II.

Statement of the Case.

A full statement of the case is given under heading "A" in the foregoing petition, and, in the interest of brevity, the same is here referred to and made a part hereof without repetition.

III.

Specification of Errors.

1. The Circuit Court of Appeals erred in finding and holding that a statutory "net loss" (within the

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* The application in the *Woolford case* was granted January 25, 1932.

meaning of Sec. 206 (*b*) of the Revenue Act of 1926) incurred by a corporation in one year (the fiscal taxable year ending June 30, 1924), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act, 1926) of an affiliated group, of which such corporation is a member, in a subsequent year (the fiscal taxable year ending June 30, 1925) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234 (*a*) of the Revenue Act of 1926.

2. The Circuit Court of Appeals erred in holding that

(*a*) The fact that one person owns all or substantially all of the stock of the corporation at all times does not change the rule announced by the Court set out in Paragraph 1 above.

(*b*) The fact that the tax ultimately fell on one individual, who was the owner at all times of substantially all the stock in all of the corporations involved, the five companies so owned having been created by carving three out of the two which had sustained the let loss, did not alter the general rule announced by the Court as applicable, and as set out in Paragraph 1 above.

3. The Circuit Court of Appeals erred in affirming the judgment of the District Court of the Northern District of Texas wherein judgment was rendered against petitioners and in favor of Respondent.

ARGUMENT.

The Circuit Court of Appeals in this case has decided important questions of Federal Law which have not been, but should be, settled by this Court.*

(*a*). The first reason for the allowance of the Writ in the petition shows the question involved and the importance of a decision by this Court. (See Sec. *a* of said Petition, page 8.) The statement of that reason is not repeated here. While no attempt is made in this brief to present a thorough argument on the merits of petitioner's contention, a brief analysis of the pertinent statutory provisions is made for the purpose of presenting clearly the question involved and the importance of a decision thereon by this Court.

The question in this case involves the determination of consolidated net income. We discuss, first, the provisions for the determination of the net income of a single tax payer.†

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*The argument appearing in the brief of Mr. W. A. Sutherland, at Atlanta, in support of the Petition for Writ of Certiorari, in the case of *Woolford Realty Company, Inc.*, v. *Rose, Commissioner*, Cause No. 582, filed in this Court, is, with his permission, here adopted as sub-section (*a*) hereof.

† * * * Throughout this brief, reference to Section and Article relate to Sections of the Revenue Act of 1926, and Articles of Regulation 69, unless otherwise indicated. (It may be added here that if there is doubt as to whether this case is controlled by the Act of 1924 or 1926, Sec. 206-*b* is identical in the two Acts, and that the defendant has contended throughout the litigation that the Act of 1926 applies.)

Section 232 provides:

> "SECTION 232. In the case of a corporation subject to the tax imposed by Section 230 the term 'net income' means the gross income as defined by Section 233, less the deduction allowed by Sections 234 and 206 * * *."

Section 234 (*a*) provides:

> "SECTION 234 (*a*). In computing the net income of a corporation subject to the tax imposed by Section 230, there shall be allowed as deductions: * * *"

(There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income except *"net losses"* brought forward from preceding years, which is covered by Section 206.)

Section 206-*a* provides for the determination according to peculiar statutory provisions of what that Section designates as a "net loss". That the "net loss" defined in Section 206-*a* is a statutory concept and not to be confused with *loss* in general, is made clear by Article 1621 of the Regulations, which provides:

> "Article 1621. * * * The amount properly allowed (as a 'net loss') may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to statute * * *."

Section 206-*b*, with reference to the deductions of these statutory "net losses" from gross income in succeeding years, provides:

"SECTION 206-*b*. If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this Section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this Section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Section 240-*b*, covering cases where corporations are affiliated and a consolidated return is filed, provides:

"SECTION 240-*b*. * * * the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in the proportions provided. * * *"

Article 635 of Regulations 69, promulgated under Section 240, eliminates intercompany transactions, and provides:

"ARTICLE 635. Subject to the provisions covering the determination of taxable net income of separate corporations, * * * the consolidated taxable net income shall be the combined net income of the several corporations consolidated * * *."

A mere reading of the provisions of the statute and regulations with reference to the determination of con-

solidated net income would seem to make it too clear for argument that the net income of a consolidated group is to be computed by taking the aggregate of the gross income of each member of the group and subtracting from this aggregate gross income the aggregate of all the deductions provided for each member of the group. Article 31 (*a*) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, expressly provides that consolidated net income is to be determined in this manner.*

The Circuit Court of Appeals has recognized the propriety of subtracting from the aggregate gross income of the five corporations all of the deductions allowable to each of the members of the group by Section 234 (*a*), notwithstanding the fact that the aggregate of the deductions allowed on account of the Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, by Section 234 (*a*) was in excess of their respective gross income. But the Court has denied the propriety under such circumstances of deducting from gross income the "net

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*"Reg. 75, Art. 31 (*a*). *Definition.*—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions')." (Cf. Rev. Act. 1928, Sec. 141.)

loss'' deductions of those companies, respectively, allowed by Section 206 (*b*). There is no basis whatever for making any distinction in a consolidated return between the deductions allowed by Section 234 (*a*) and those allowed by Section 206 (*b*). If the former deductions are permitted when in excess of the gross income of the separate corporation sustaining same, the latter must likewise be allowed.

From the opinion as a whole, it seems that the Court reaches its decision adverse to petitioners' contention upon the theory that the construction for which petitioners contend would accomplish an inequitable result and a result ''generally inappropriate to the Federal scheme of income taxation designed as it is *with the sole exception of the statutory net loss provision* to make each person subject to the tax pay taxes on his income for the year in which it accrues.'' (Italics ours.) This brief does not permit a full analysis of the error of this view. The fallacy of the assumption upon which this holding is based is clearly established by the fact that in Article 41 (*c*) of Regulations 75, promulgated under substantially similar provisions of the Revenue Act of 1928, the Commissioner and Secretary of the Treasury expressly permit the deduction which petitioners here contend is allowable.*

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* ''Art. 41 (*c*). *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*—A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss prior to the taxable year 1929) shall be allowed as a

The language in some portions of the opinion of the Circuit Court of Appeals seems to indicate that the Court assumes that the literal language of Section 206 (*b*), to the effect that the net loss deduction is to be allowed in the succeeding year in computing "the net income of the taxpayer" (Italics ours), requires that this deduction be limited to the individual taxpayer which sustained the loss. It could be argued with as much reason that the ordinary deductions allowable under Section 234 (*a*) cannot be used in the computation of consolidated net income because Section 234 (*a*) provides that "in computing the net income of *a corporation* subject to the tax imposed by Section 230, there shall be allowed as deductions" (Italics ours) the items there listed. The argument that the literal words of either section do not provide for the allowance of these deductions in the computation of consolidated net income would be clearly erroneous. Of course, Sections 234 (*a*) and 206 (*b*) refer to single taxpayers. But Article 635, promulgated under Section 240, which provides that the net income of the consolidated group shall be "the combined net income of the several corporations consoli-

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deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated net income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

dated", necessarily means that all the items of gross income and all the deductions of the individual taxpayer must be taken into account. Otherwise it means nothing, and leaves to the Commissioner's caprice in each individual case, or to the individual opinion of whatever court happens to be considering the matter, the determination of what, and under what circumstances, deductions are or are not allowable in a consolidated return. Section 240 and Article 635 expressly provide for the extension and enlargement of the provisions of the Act relating to gross income and deductions of single taxpayers to make them applicable to an affiliated group. They do not leave to the Commissioner any more latitude in saying which of the particular deductions granted by statute shall be allowed to the consolidated group than they leave the Commissioner or a court to say what deductions shall be permitted to a single taxpayer.

In other portions of the opinion it is intimated that the petitioners' contention requires the concept of "net income" as a minus quantity. Such is not the case if the provisions of Article 635 are interpreted, as we interpret them, as providing for the computation of consolidated net income by deducting from the aggregate of the gross income of the several corporations the aggregate of the deductions allowable under Sections 234 (*a*) and 206 (*b*). If, however, Article 635 is taken to require the computation of net income for each separate corporation and then the combination of these separate net incomes, the concept of a net income as a minus quantity is necessary. "Net income", as

used in the Act, *is a creature of statute* and is fully defined in Section 232. We find no difficulty in admitting the concept of net income as a minus quantity. It will always be a minus quantity when the deductions allowable by Section 234 (*a*) or Section 206 (*b*), or both combined, exceed gross income as defined in Section 233. In this case, the Commissioner himself has allowed a minus figure (which, upon his theory, must be *minus net income*) for both the Planters Cotton Oil Company of Waxahachie and the Planters Cotton Oil Company of Ennis, to be combined with the net income of the three corporations in arriving at the consolidated net income. The Court and Commissioner have refused to permit these minus figures to be increased by the deduction allowable under Section 206 (*b*).

(*b*) The Circuit Court of Appeals, as pointed out in Section (*b*) of the Reasons Relied upon for the Granting of the Writ, Application for Writ of Certiorari (p. 8), held not only that a statutory net loss accruing to a corporation when unaffiliated with any other corporation may not be used by it in a subsequent year when affiliated with another, in computing, not only its own income, but the income of the other members of the group (following its own decision in the *Woolford case*); *but further held that the fact that a single individual may at all times own substantially all of the stock in each of the corporations composing the group, that the tax will ultimately fall upon such individual, and that the creation of the additional corporations constituted a mere paper change, was wholly immaterial in the application of its announced rule.*

It is submitted that this additional holding of the Circuit Court of Appeals, in the instant case, likewise decides an important question of Federal law which has not, but should be, settled by this Court.

As has already been shown, on June 30, 1924, the end of the fiscal taxable year, there were then in existence only two of the taxpayers, Planters Cotton Oil Company, Waxahachie, and Planters Cotton Oil Company, Ennis, which were affiliated; that H. N. Chapman owned over 95 per cent, or substantially all, of the stock in each. That during the fiscal taxable year ending June 30, 1925, three additional corporate taxpayers, Planters Cotton Oil Company, *Inc.*, of Waxahachie, Planters Cotton Oil Company, *Inc.*, of Ennis, and Farmers Gins, Inc., were carved out of the original two, and that H. N. Chapman owned over 95 per cent, or practically all, of the capital stock of each of the new companies. It was agreed that at the end of the fiscal taxable year, June 30, 1925, there were then five members of the affiliated group, whereas, there were only two the year before, but that the five owned identically the same assets as did the original two, as the entire corporate property of the three consisted of assets transferred to them, respectively, by the two original members (Record, pp. 3, 4, 5).

The Circuit Court of Appeals, in its opinion, says:

> "* * * that one person has at all times been substantially the owner of all of the stock in all the companies involved, and the tax ultimately fell on him because he at all times owned all of the companies, in the *Slag case* two companies so owned, having been consolidated, in this case

five companies so owned, having been created by carving three out of the two which has sustained the net loss."

The Court then adds that it becomes necessary to consider whether or not this fact leads to a different conclusion to that reached in the *Woolford case,* and, in answer to the question, says that "we do not think they do."

Further quoting the findings from the Circuit Court's opinion:

> "Unless therefore the fact that Chapman is and has at all times been substantially the sole owner of stock of both the unincorporated associations from which the corporate tax payers sprang, and of the corporations, gives him warrant to assert that in reality he has at all times been the tax payer, and the losses and gains have been his, the deduction may not be allowed."

The net losses and net income of the corporate group for the fiscal taxable years ending June 30, 1924, and June 30, 1925, were as follows:

	1924	1925
Planters Cotton Oil Company, Waxahachie	$182,284.86 (loss)	$72,699.65 (loss)
Planters Cotton Oil Company, Ennis	23,746.86 (loss)	5,699.60 (loss)
Planters Cotton Oil Co., Inc., Waxahachie		52,981.25 (net income)
Planters Cotton Oil Co., Inc., Ennis		79,476.21 (net income)
Farmers Gins, Inc.,		15,178.79 (net income)
Total Net Loss	$206,031.03	
Net income of the group for the year 1925, without taking into consideration the 1924 loss, amounted to		$69,237.00

(Record, pp. 4 and 5.) This is the amount upon which the tax sued for herein was paid. It is readily apparent that if the loss sustained by the two affiliated associations in 1924 had been allowed as a deduction, amounting to the sum of $206,031.03, there would have been no net income for the year 1925, but, on the contrary, a net loss by the group of $136,794.03. It is further evident and apparent that, if there had not been a carving out of the two original companies, of the three new ones, the consolidated net loss of the two old companies would have been the sum of $136,794.03, and that no tax would have been levied or paid. The tax levied and paid for the year 1925 was just as surely a tax levied on H. N. Chapman, in so far as result was concerned, as if he had conducted the business as an individual, or there had been only one company. The Circuit Court of Appeals admits that the tax "ultimately fell on him." The fact is that Chapman has paid practically $9,000.00 taxes upon an income that did not exist.

In its opinion in the case of *Woolford Realty Company* v. *Rose*, the Circuit Court of Appeals says:

> "While appellant does find support for the position which it takes in the opinions of the Tax Board, we cannot agree with the view which the Board takes. Whether the decision in the *National Slag case, supra,* was or not correct, it did not decide the point before us. That case merely decided that since one Buckland had, during the years in which the statutory net losses were sustained, as well as during the years of affiliation, owned both of the enter-

> prises, the loss was really his loss, and the statute should be construed so as to give him the benefit of it."

The decision in the *Slag case* was rendered by the Circuit Court of Appeals, Third Circuit, 47 Federal (2) 846. The Circuit Court of Appeals, in the instant case, expressly admitted that the facts in this case and in the *Slag case* were parallel, or on "all fours," in that (further quoting from the text of the opinion),

> "Since, however, the differentiating facts appear here as they did in the case of *National Slag Company* v. *Commissioner,* 47 Federal (2) 846, that one person has been at all times substantially the owner of all the stock in all the companies involved and the tax ultimately fell on him, because he, at all times, owned all the companies, in the *Slag case* the two companies having been consolidated, in this case five companies so owned having been created by carving three out of the two which had sustained the let loss * * *."

The facts in the *Slag case* showed that one Buckland owned in one of the companies 9,998 shares out of 10,000, and 3,296 out of 3,000 shares outstanding in the other. After referring to the applicable statutes, the Court, in the *Slag case,* says:

> "These sections make it perfectly plain that if the tax payer in the case at bar had been an individual, he would have had the right to deduct the losses for 1922 and 1923 from his 1924 tax return";

and further:

> "In view of the fact that Buckland owned both companies before and after incorporation of the Slag Company, it seems on principle that the provisions of Section 206 should apply to the consolidated return of the affiliated companies."

The Circuit Court of Appeals, Fifth Circuit, in this case, came to an entirely different conclusion to that reached by the Circuit Court of Appeals, Third Circuit, in the *Slag case* upon a similar state of facts, and we respectfully submit that the conclusion reached in the *Slag case* is correct. The Circuit Court of Appeals, in the instant case, admits:

> "That the facts in this case present a situation of which, if the matter were to be singly determined upon considerations of general fitness, it might well be said, as the Court did in the *Slag case*, 'it seems on principle that the provisions of Section 206 should apply to the consolidated returns of these affiliated companies,' but the question may not be decided upon such considerations."

The Court then came to the conclusion that while "considerations of general fitness" would be favorable to petitioners, consideration of the law applicable to the facts would lead to a different result.

We respectfully submit that not only is the position of petitioners sustained by "general fitness," but also by the decisions of this Court, as well as various Courts of Circuit Appeals, in addition to the *Slag case*.

In the case of *Southern Pacific Co.* v. *Lowe*, 247 U. S.

330, 38 Sup. Ct. Rep. 540, 62 L. Ed. 1142, suit was filed by the Southern Pacific Company to recover alleged over payment in income taxes. It appeared that the income tax in dispute was represented by certain dividends paid to the Southern Pacific Company by the Central Pacific Railway, whose entire capital stock was owned by the Southern Pacific. The two companies were technically separate identities. Judgment having been rendered against the Southern Pacific in the trial Court, the case was reviewed and reversed by this Court. The Court, in its opinion, says:

> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing the entire net income arising or accruing from all sources during each year, commencing the 1st day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; *and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former, as stockholder and other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter acting merely as its agent and subject in all things to its proper direction and control. And besides the funds represented by the dividends were in the actual possession and control of the Southern Pacific as well before as after the declaration of the dividends. The fact that the books were*

> *kept in accordance with the provisions of the lease, so that the funds appeared upon the accounts as an indebtedness of the lessee to the lessor connot be controlling in view of the practical identity of the lessor and lessee.''* (Italics supplied.)

In *Gulf Oil Corporation* v. *Lewellyn* (an income tax case), 248 U. S. 71, 39 Sup. Ct. Rep. 35, 63 Law Ed. 133, the Court uses the following pertinent language:

> "But disregarding the forms gone through, the result was that the petitioner became the holder of the debt previously due from one of its companies to the other. It was no richer than before, but its property now is represented by stock in and debts due from its subsidiaries, whereas formerly it was represented by the stock alone, the change being effected by entries upon the respective companies' books."

In the case of *Western Maryland Ry. Co.* v. *Commissioner,* 33 Federal (2) 695 (C. C. A. Fourth Circuit), the Court uses this language:

> "After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law, but regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require'."

In the instant case, after three new companies were "carved" out of the original two, *they were no richer; they held the same property; they represented the same ownership.* They were separate in form only; they were the alter ego of H. N. Chapman (see decision by the Fifth Court of Appeals, *Jackson* v. *Thomas Investment Company,* 46 Federal (2) 252); and it is apparent and undeniable that the losses and income would have been identical for the year 1925 if the three new companies had never existed, in which case there undeniably would have been no tax due. The Courts have many times recognized the rule that where there is a practical identity between corporations, their separate legal entities will be disregarded. This rule has been applied to varying facts including tax cases. The only question is, Does it apply in the matter of income taxation? We respectfully submit that if applied in any case, it should apply to such a case, upon the authority of the line of decisions by this Court, of which *Burnett* v. *Niagara Falls Brewing Company,* 282 U. S. 648; 51 Sup. Ct. Rep. 262; 75 Law Ed. 594, is typical, holding that tax laws are to be construed liberally in favor of the taxpayer.

B.

The decision of the Circuit Court of Appeals in this case is in direct and admitted conflict with the decision of another Circuit Court of Appeals on the same matter.

The admitted conflict between the holding of the Court in the instant case and that of the Circuit Court of Appeals, Third Circuit, in the *Slag case,* 47 Federal

(2) 846, has been previously pointed out and reference is here made thereto without repetition.

C.

The Statutes involved herein are clear and unambiguous, and reasonably admits of but the one construction herein insisted upon, but, even if such statutes (as held by the trial court) "are not clear," the rule of construction favorable to the taxpayer should be adopted. This the Circuit Court of Appeals failed to do. The trial court in this case stated in his opinion that "the question is troublesome. The use that may be made of a loss is not clear." Again, after quoting Section 206 (*b*), he says: "Without the words 'computed without such deduction,' the statute would be even less clear * * *"

This Court has held many times that ambiguities in taxing statutes would be construed in favor of the tax payer, and that the rule of strict construction would be applied. The rule is admirably stated in *Burnett, Commissioner,* v. *Moore Cotton Mills,* 49 Federal (2) 59, Circuit Court of Appeals, Fourth Circuit, referring to a statute similar to the one here involved:

> "Also, should we assume ambiguity to exist in the phraseology in construing a tax statute of this kind, any such ambiguity should be construed in favor of the taxpayer,"

citing the following cases decided by this Court:

Gould v. *Gould,* 245 U. S. 151, 38 S. Ct. 53; 62 L. Ed. 211;

U. S. v. *Merriam,* 263 U. S. 179; 44 S. Ct. 69; 69 L. Ed. 240; 29 A. L. R. 1547;

Reinecke v. *Trust Co.,* 278 U. S. 339, 49 S. Ct. 123; 73 L. Ed. 410; 66 A. L. R. 397.

Conclusion.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that the important questions of Federal Law decided below may be finally settled by this Court and that the conflict in the decisions of the Courts of Circuit Appeals may be reconciled, and that to such an end a Writ of Certiorari should be granted and this Court should review the decision of the Circuit Court of Appeals and finally reverse it.

JOE A. WORSHAM,
Dallas, Texas,
J. M. BURFORD,
Dallas, Texas,
J. L. GAMMON,
Waxahachie, Texas,
Counsel for Petitioners.

WORSHAM, ROLLINS, BURFORD,
RYBURN & HINCKS,
Dallas, Texas,
Of Counsel.